

DATE: October 4, 1989

TO: Lawrence Grissom, Retirement Administrator
FROM: City Attorney
SUBJECT: Applicability of the Internal Revenue Code
Section 415 on the City Employees' Retirement
System

You recently provided this office with a memorandum dated September 21, 1989, which indicates that a member of the City Employees' Retirement System Board of Administration, who is a private attorney specializing in ERISA matters for his firm's clients, raised the question of whether or not the City Employees' Retirement System was subject to Section 401(a) of the Internal Revenue Code and therefore Section 415.

We can understand the board members' confusion in this matter. The Employment Retirement Income Security Act of 1974 (ERISA) (29 U.S. Code section 1001 et seq.) by its own terms in section 1003 does not apply to governmental plans as defined in 29 U.S. Code section 1002(32). A governmental plan is defined in that section as a "plan established or maintained for its employees by the government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing." This is identical to the definition found in section 414(d) of the Internal Revenue Code, 26 U.S. Code 414(d). Unfortunately, although The City of San Diego is exempt from ERISA, it must qualify under the provision of subchapter D, Part I of the Internal Revenue Code beginning with section 401(a) in order to receive favorable tax treatment. One of the qualification requirements is that a plan cannot allow for the possibility that benefits will be provided in excess of those permitted under Internal Revenue Code section 415. That requirement is found in section 401(a)(16). Therefore, if section 415 limits are exceeded, a governmental plan will lose the following advantages of a qualified plan.

1. A participant is not taxed on the earnings on his/her contributions while they remain on the plan.
2. A participant is not taxed on his/her share of contributions made by the employer and the earnings on those contributions while they remain on the plan.
3. Participant or his/her beneficiary is entitled to special tax treatment on distributions in certain circumstances.

4. In accordance with section 414(h) of the Internal Revenue Code, employee contributions may be "picked up" by the employer.

Of course, a non-qualified plan loses all these advantages.

Governmental plans are, however, exempt from certain requirements found in the Internal Revenue Code that had their genesis in ERISA. Section 410(c)(1)(A) exempts governmental plans from the minimum participation standards of that section. Section 411(e)(1)(A) exempts governmental plans from its minimum vesting standards and section 412(h)(3) exempts governmental plans from its minimum funding standards. To our sorrow, section 415 which applies to limitations on benefits and contributions under qualified plans does not provide a total exemption for governmental plans. However, it does provide special rules for governmental plans in subsections (F), (G) and (H) of section 415(b)(2). In addition, section 401(a)(26)(H) also provides for special participation rules for public safety employees. It is, therefore, abundantly clear that both sections 401(a) and section 415 are applicable to governmental plans for tax qualification purposes.

We take this opportunity to advise both you and the Retirement Board of Administration that one need not place his ear to the railroad track to find out which way the IRS locomotive is travelling. In Volume 54, No. 95 of the Federal Register, dated May 18, 1989, at page 21440, the Internal Revenue Service, in giving notice of proposed rule making, stated quite clearly:

Since August 1977 (see News Release IR-1869 dated August 10, 1977), the Service has not raised the issue of nondiscrimination under section 410 or 401(a)(4) in the case of governmental plans. Beginning with the 1989 plan year, governmental plans must satisfy the applicable nondiscrimination requirements. In lieu of satisfying section 410(b),

governmental plans and church plans must satisfy section 401(a)(3), as in effect prior to the enactment of the Employee Retirement Income Security Act of 1974 (ERISA).

The proposed rule on page 21443 reads as follows: "(6) Certain governmental or church plans. A plan satisfies this paragraph (b)(6) for a plan year only if it is described in section 410(c) and such plan satisfies the requirements of section 401(a)(3) as in effect on September 1, 1974."

As you can see from the above, even though governmental plans

may be exempt from certain Internal Revenue Code rules and have been fairly safe from Internal Revenue Service scrutiny for over a decade, administrators of such plans should be aware that they are now subject to the piercing eyes of the Internal Revenue Service and should act accordingly.

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By

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